DOW THEORY LETTERS INC.

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THE PICTURE: U.S. News & World Report conducted a late-November, 1971, poll of approximately 600 bankers regarding the trend of the stock market during 1972, and the estimated level of the Dow for mid-1972 (see clip). The results, I believe, make for an interesting "contrary opinion". As I compute it, just over 1% of the bankers believe that stock prices will be sharply down during most of 1972 and 1% believe the Dow will be "under 700" by mid-1972. That gives you some idea of the fantastic institutional "enthusiasm" which I have been talking about in recent Letters. Such enthusiasm during a primary bear market can be a very dangerous affair.

The fact is that slowly, almost imperceptably in many cases, this primary bear market is taking its toll. For instance, last week American Telephone dropped to a low for the year at 40 3/4. Thus the nation's most widely held stock came within a fraction of its 1970 low, a level which has not been seen since 1960 (the 1964 bull market peak for Telephone was 75, in case you don't remember).

A second subtle casualty of this bear market (as I warned it would) has been dividends. This may astound most readers, but over the past five years the dividends on the D-J Industrials have declined by an average of nearly three-quarters of 1% annually, and this during the period of the worst inflation since World War II. This little realized fact is documented on the page 2 chart (chart courtesy of Security Research, 208 Newbury St., Boston, Mass. 02116).

Turning to the market itself, now might be a good time to refresh readers' minds regarding the rate of

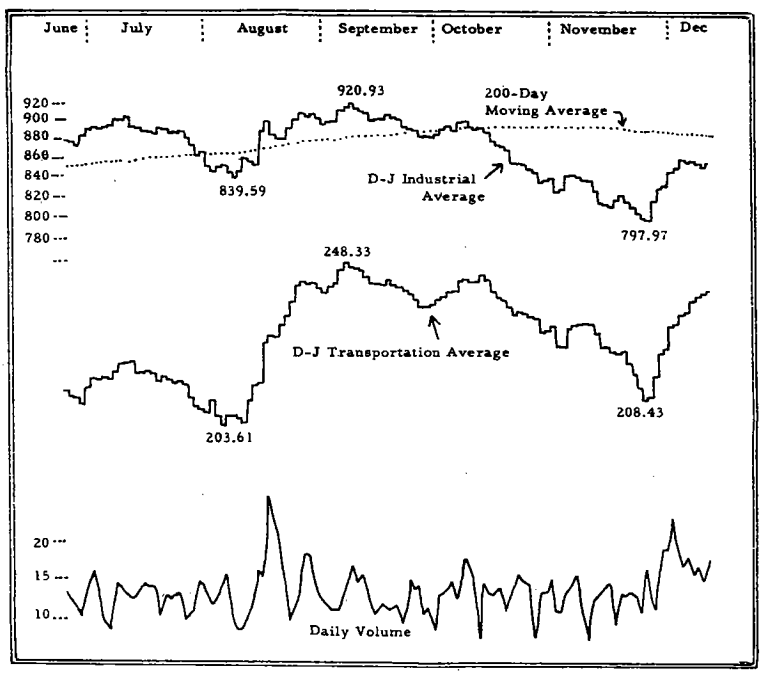
WHERE
STOCKS
ARE HEADED

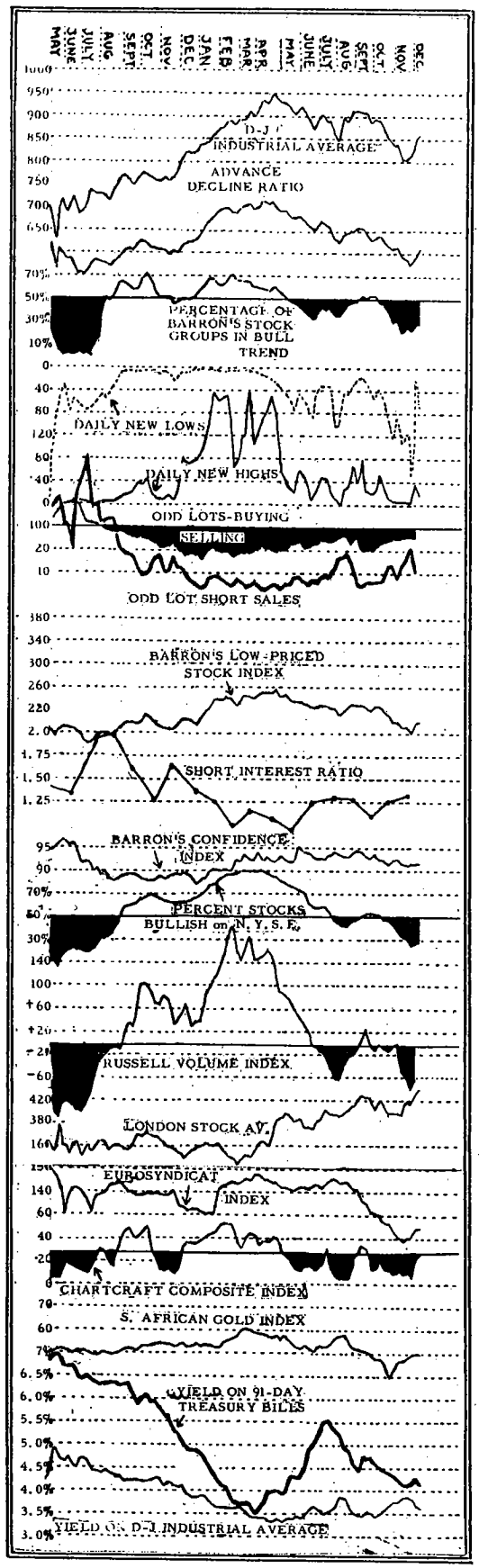
Q What will be the broad trend of stock prices during most of 1972?

Sharply upward	95 bankers
Moderately upward	403 bankers
Not much change	56 bankers
Moderately down	39 bankers
Sharply down	8 bankers

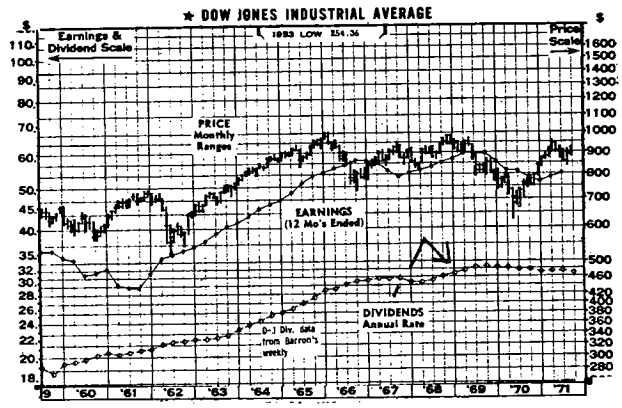
Q Where will the Dow Jones industrial average be at mid-1972?

Under 700	6 bankers
700-750	17 bankers
750-800	43 bankers
800-850	74 bankers
850-900	142 bankers
900-950	214 bankers
950-1,000	85 bankers
Over 1,000	15 bankers

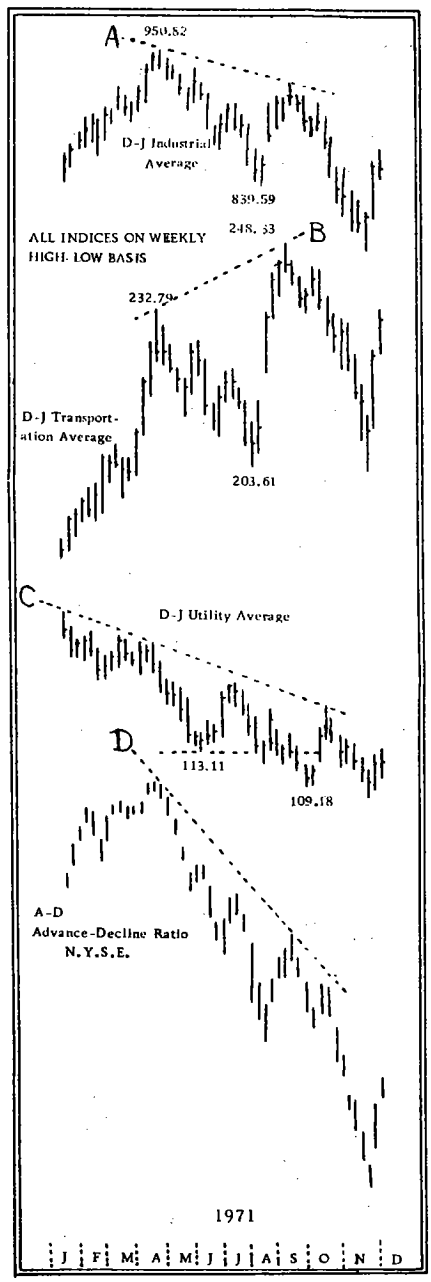




advance or decline during a primary trend. Market history shows that the long, extended movements tend to be with the primary trend, while the short, violent movements tend to be against the primary trend. Thus, during a bear market, for instance, a downward movement of a few months or more might be corrected (perhaps 1/3 to 2/3's of the losses regained) in a period of a few days to a few weeks.


★ DOW JONES INDUSTRIAL AVERAGE
Earnings & Dividend Scale
1953 Low 254.36
Price Scale
PRICE Monthly Ranges
EARNINGS (12 Mo's Ended)
DIVIDENDS Annual Rate
D-J Div. data from Barron's weekly
'59 '60 '61 '62 '63 '64 '65 '66 '67 '68 '69 '70 '71

In the current market, the decline from the September 8 Dow peak of 920.92 (see chart on page 1) to the November 23 low closing of 797.97 consumed 55 trading days. Those 55 trading days erased 122.98 points from the Dow. Then in six trading days from November 23 (Dow at 797.97) to December 3 (Dow at 859.59) the Dow regained half of all the losses of the preceding 55 days. Thus, the time element of the decline from the September peak and the rally from the November low has bearish implications. It is a time element characteristic of a decline and rally in a primary bear market.



I want to stress again the highly speculative nature of this market, despite the fact that the primary trend is bearish (and "enthusiasm" during a bear market is a decidedly bearish phenomenon, comparable to bearishness during a bull market, which is a decidedly bullish phenomenon). Note on the narrow page 2 chart that the highest quality of the three Dow Averages, the Utilities, showed least tendency to rally during 1971. The good-grade Industrial Average rallied considerably more than did Utilities. But the speculative Transportation Average showed the best rallying tendencies. This is indicative of the huge residue of bullishness which persists in this primary bear market. As I said in the last Letter, the ending of the second (psychological) phase of the bear market should see a pulverizing of the speculators, and with it a massive collapse in the highly-leveraged, speculative Transportation Average.

I exchange reports with a great many investment advisory publications across the nation, and I note that they are turning strongly and widely bullish again. They seem transfixed by short-term trends, and many of them pride themselves on being able to "telegraph" buy and sell signals on an almost daily basis. I am not, and never have been, concerned with "in-and-out" trading, and in my experience most of the short-term traders end up going back to their own business, usually after a year or so of being whipsawed on Wall Street.

This bear market has now been in force for five-and-one-half years, and despite the fact that many stocks have been hit badly and despite the fact that very few stocks are near their highs, there remains a stubborn bullish sentiment, a sentiment which will not die. That sentiment can probably be traced to the persistent all-out efforts of the Government to keep this market and economy plowing ahead (the latest effort was the reduction of stock margins to 55% and cutting the discount rate to 4 1/2%).

Nevertheless, the second phase of the bear market began in October, 1966, so that it has been five years for this second phase. The second phase of the 1949-66 bull market lasted from 1953 to 1957, only four years, and in general a bear market is shorter than the bull market which precedes it. Therefore, I feel that we should rapidly be drawing to the close of this second phase, regardless of what Mr. Nixon and Mr. Connally can "pull out of the hat". Because of the time element, I feel that 1972 will probably bring in more troubles than anything seen during 1971.

Remember, the year 1971 started out "looking good," and it ended up "feeling costly". This is par for the course during a primary bear market. During bear market years it is entirely normal for the highs for the year to be seen early or around the first quarter. Then as the situation continues to decay, the market slumps, and very often the last quarter witnesses new lows for the year. Thus, 1971 conformed in many ways to a typical bear year, except that the last quarter selling was vicious only in selected issues. With time growing late, I would guess that 1972 will see liquidation of the widespread variety. In fact, I would not be surprised at all to see the entire structure of the market cave in during 1972 with the 631.15 Dow low of May, 1970, smashed, as the Industrials probe deep down, bowed by the weight of massive and panicky selling.

VOLUME: On December 1, 1971, volume boomed to 21 million shares as the Dow Industrials closed at 846.01. That day marked the 25th day in 1971 with volume of over 20 million shares! Actually, volume of over 20 million shares is a very rare occurrence. The year 1968 saw only 4 over-20 million share days, 1969 produced no such days and 1970 only 5 over-20 million share days.

I have included a tabulation of all the over-20 million share days of 1971, all 25 of them which have appeared so far. Now note that the latest instance, the 21 million shares of December 1 occurred with a Dow closing of 846.01. That means that December 1 saw the Dow close below all the other ultra-high volume days of 1971. This is what I term, "burning up the fuel". Why do I say that? Because an over-20 million share day on the upside means great enthusiasm, and we very definitely saw great enthusiasm on December 1.

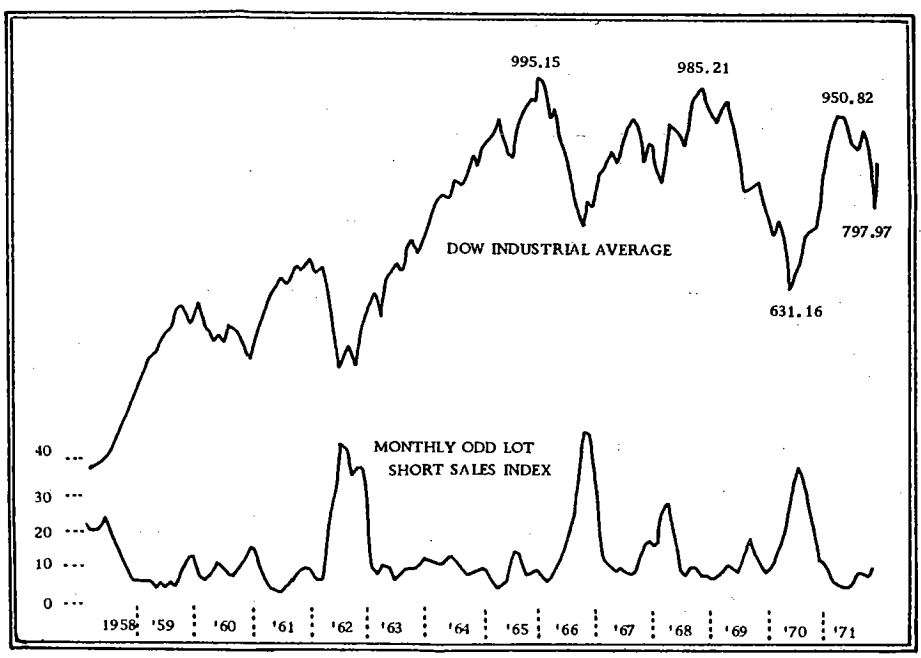
DATE	VOLUME	DOW CLOSE	DATE	VOLUME	DOW CLOSE	DATE	VOLUME	DOW CLOSE
1/22/71	21,680,000	861.31	2/8/71	25,590,000	882.12	4/15/71	22,540,000	938.17
1/26/71	21,380,000	866.79	2/9/71	28,250,000	879.79	4/23/71	20,150,000	947.79
1/29/71	20,960,000	868.50	2/16/71	21,350,000	890.06	4/27/71	21,250,000	947.09
2/1/71	20,650,000	877.81	3/5/71	22,430,000	898.00	4/28/71	24,820,000	950.82
2/2/71	22,030,000	874.59	3/9/71	20,490,000	899.10	4/29/71	20,340,000	948.15
2/3/71	21,680,000	876.23	3/16/71	22,270,000	914.64	8/16/71	31,730,000	888.95
2/4/71	20,860,000	874.79	4/7/71	22,270,000	918.49	8/17/71	26,790,000	899.90
2/5/71	20,480,000	876.57	4/13/71	23,200,000	927.28	8/18/71	20,680,000	886.17
						12/1/71	21,040,000	846.01

But the surge of enthusiasm on December 1 came with the Dow 104 points under its 1971 high closing (April) of 950.82. With 25 over-20 million share days in 1971, it would seem that the Dow should be up in record high territory over 1,000. But that is hardly the case. My conclusion is that under the guise of great enthusiasm, informed investors have been distributing stocks in huge quantities during 1971. That is why, with a record number of record volume days, the Dow broke to a low for the year in the fourth quarter, and that is why I term all the massive volume of 1971 as part of a giant distribution. I would guess that the fruits of that distribution will be seen during 1972 and 1973.

ODD-LOT SHORT SALES: I have studied the level of odd-lot short sales on the decline which began in September. Traditionally, the odd-lot short seller doesn't get his nerve up until a decline gets well under way. Then he tends to increase his speculations on the decline until a point where his shorting activities can only be described as reckless. At this point, the market usually proves to be near an important bottom.

The accompanying chart is re-drawn from the December 4 issue of the Drew Odd Lot Studies (30 Congress St., Boston, Mass.). These odd-lot short sales figures are monthly average figures and are particularly useful since they show comparisons going back 14 years.

The odd-lot short sale statistic for the month of November was a low 10.6. This compares with figures over 40 near the bottom of the 1962 and 1966 declines and a figure just under 40 at the 1970 bottom. During the decline which began in mid-1967 and ended in early-1968 (see chart), a decline which Mr. Drew notes was very similar to the current one, the odd-lot short sales index climbed to around 28. Thus the November reading of 10 on the index, as Mr. Drew puts it, "....remains remarkably low in view of the background."



In fact, I would say that this November reading is too low to suggest anything more than a temporary rally, and if the rally continues to the end of the year (amid continuing Administration "bally-hooing" of the economy), the bear should take over again during the early part of the first quarter.

I consider the lack of odd-lot short sales as a negative factor in the technical background, and it underscores what I was saying in the last Letter regarding the remarkable "upside enthusiasm" which persists in this bear market, despite the fact that the Dow has not been to new highs for over five years, the longest such period seen in this generation.

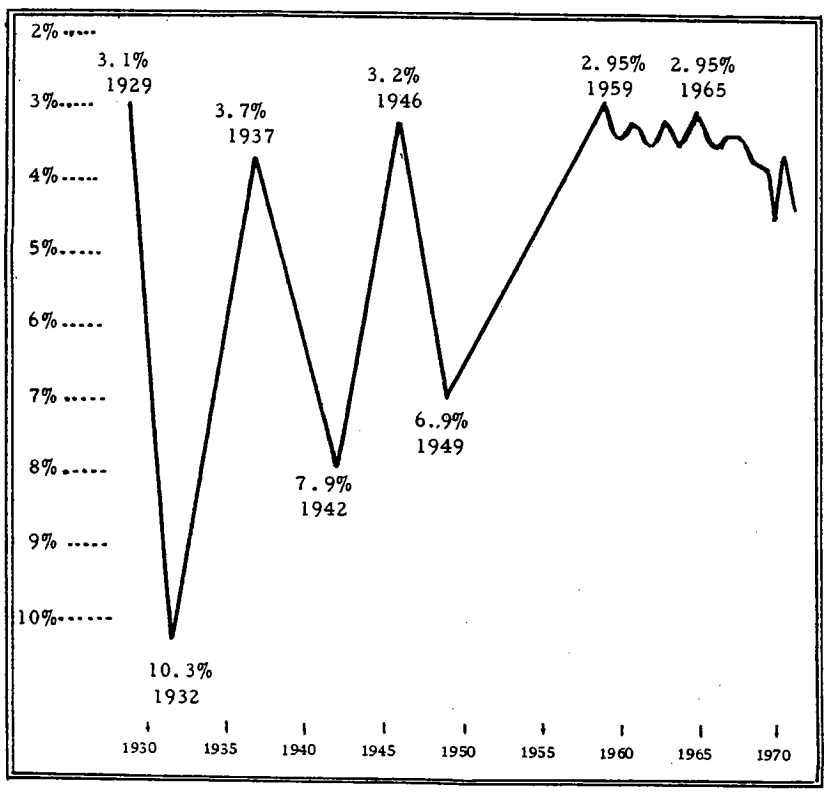
But just as it took nine years from 1949 (when the 1949-66 bull market began) to turn the public bullish on the primary bull trend, so it may take another six months or a year to turn the public bearish on the primary bear trend which began in February, 1966. But bearish they will turn, and this will mean that we are near the end of the second psychological phase of this bear market.

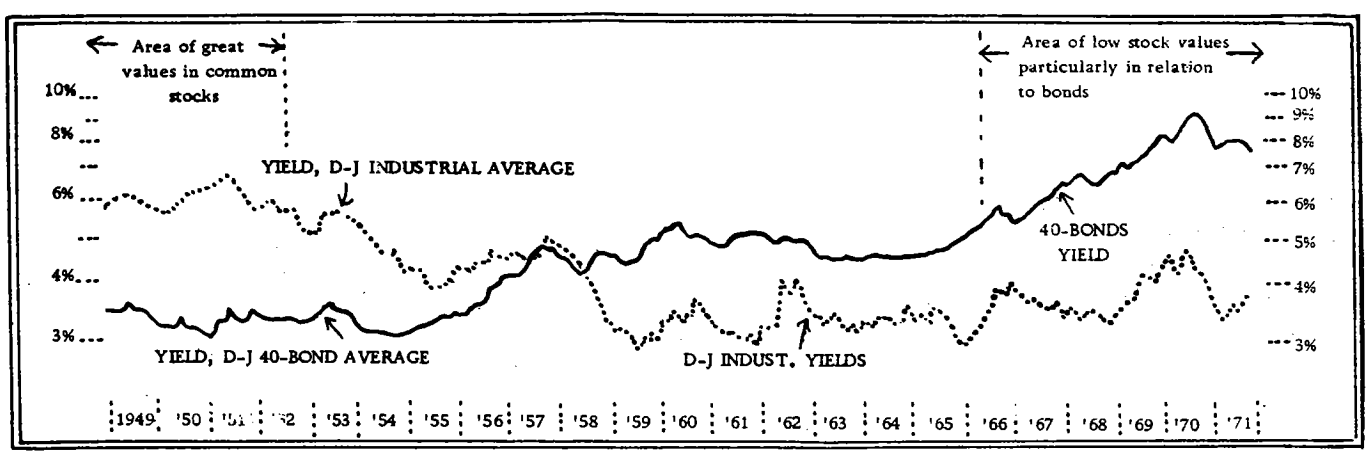
Before the second phase is over, regardless of how many rallies and declines we may have witnessed, I expect the Dow to break well below its 1970 low close of 631.16 recorded in May. Then we will have another corrective rally, and finally the third phase of the bear market. That will be the phase where psychology turns absolutely cold on common stocks. It is during that final third phase decline that equities will be on the great "bargain table". Those who have the patience to wait for the third phase period will have the opportunity of buying stocks which will, in time, make fortunes for their owners. But courage, wisdom and as Dow put it, "the patience of ten men" will be needed.

VALUES: One of the gauges which Charles H. Dow applied to stock values was the return to the investor. Dow knew that ultimately there must be a "pay-off" or a return to compensate one for the risk of holding a common stock. That return must ultimately take the form of a cash dividend, although many investors (particularly during the early 1960's deluded themselves into thinking that perpetual stock dividends were "better" than cash).

One of the criteria which Dow Theorists have used to gauge the peaks of bull markets and the bottoms of bear markets is the average yield on the Dow Industrials. The average yield has fluctuated from the low areas of around 3.5% or less near bull market tops, to the 6.9% or more, zone near bear market bottoms.

I am including two charts in the yield study. The first shows that major swing in the Dow Industrials yields from 1929 to the present. Note that the Dow has been in the low yielding zone since 1959, and despite this the market has never swung to the downside in a major bear collapse which would have rendered high yields such as 1932, 1942 or





1949. The reason for this is undoubtedly the great inflationary pressures which kept stocks at "high altitude" levels for the longest period in history. For over a decade, investors have tended to stay in common stocks as an inflation hedge, almost regardless of the miniscule yields.

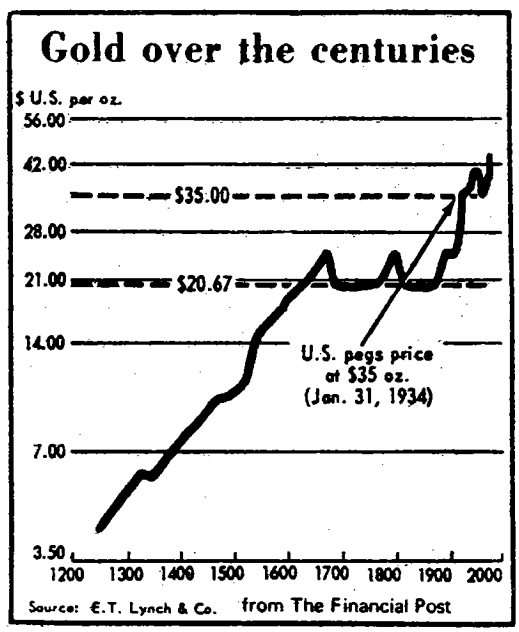
This has an unpleasant side, however, because in the market (as everywhere else) every action produces a reaction. Therefore, I would think that when the bear market heads down, either (1) yields will go to inordinately high levels, which means very low levels on the Dow, or (2) the Dow will stay at low levels, bringing high yields, for an unusually long period of time.

The second chart compares the yields on the Dow Industrials with the yields on the D-J 40 Bond Average. Here we see that a "negative spread" between stock and bond yields developed in 1958, and this has been with us ever since. As a rule, the higher the yield on bonds, the less attractive the stock market (even though inflation has obscured this thesis for over a decade). Note that during the period from 1960 to the present the spread between stock and bond yields reached their greatest negative spread.

This increases the bearish factor, even though the Dow yields are higher now than they were, for instance during late 1965 or 1959. The reason for the high bond yields now is the great pyramid of debt which has been building up in this country, plus the overload in the bond markets, plus the huge budget deficits which are sweeping across every segment of the nation from the Federal Government to the states and cities.

All things change, however, and I feel that the great yield cycle will, in time, turn down as it always has. This will probably occur towards the very end of the second phase of this bear market and during the third and final phase. At that time, there will be great bargains in high-grade stocks, the majority of which will be selling at very attractive yields. In fact, it would not surprise me to see the yield cycle move somewhere between the 7.9% of 1949 and the 10.3% of 1932 toward the very end of this primary bear market.

PERSPECTIVE: Many subscribers have written asking why in the world our Government objects to a "token" 5% to 10% devaluation of the dollar (i.e. raising the price of the dollar by 5 to 10% in relation to gold)? The answer is clear: The Administration would like to be free to inflate without the discipline of any gold at all. Treasury Secretary Connally has made it clear; he would like the dollar completely unconnected with gold.



But our foreign creditors aren't about to swallow this bitter pill. Therefore, they have been absolutely firm and united on a token rise in the price of gold. Any rise in gold's price would be symbolic. It would indicate that despite the U.S.'s endless objections, gold was officially worth more than ever (actually, gold is worth almost $44 in the free market, see last page chart, but it is against the dollar or within the U.S. that foreigners want that symbolic admission). Therein lies the great dollar devaluation controversy.

In addition to the weekly gold chart on page 6 of this report, I am including what is probably the longest-term chart ever to appear in these Letters. This is a chart going back almost 800 years showing the steady advance in the price of gold. The significance of this chart is profound. The 800 year rise in the price of gold is based on one factor, and that is that all leaders, all politicians, and all their subjects or constituents ultimately cast off their promises and frugal ways and follow the path of greed and inflation.

Thus a decade ago the dollar was thought to be "as good as gold". The towering deficits of the late 1960's and early 1970's showed this to be a lie. Now, an attempt is being made to pass SDR's off as "paper gold". But the phrase "paper gold" is a self-contained lie as much as the phrase "angel-devil" or "liquid-solid". Gold is gold, it cannot be substituted regardless of the intentions or promises of politicians, and the proof is always the same. When the crisis hits, the dollars, the SDR's, the fiat paper, they all go under as men and nations stampede towards the one immutable reservoir of value — gold.

Thus, we see the strange phenomenon of gold hitting $44 per ounce on the London market on December 6 (this was the highest price since late 1968), even while the U.S. toys with the idea of a devaluation of maybe 10%, which would put gold at around $39 per ounce. I wonder, if the U.S. does devalue and if the U.S. puts gold at $39 per ounce, will the U.S. be able to buy or accumulate gold at that price? I doubt it. According to my friend Harry Schultz, "South Africa sold all its gold on the free market in recent months, both new mined and bank reserves" (from his report of Dec. 1). With the free market taking in all gold at above $43 an ounce, it is obvious that a 10% devaluation of the dollar is merely a first step, a token, preparatory to the next

 phase, which should be a doubling or tripling of the gold price (which will probably take place during the coming depression).

Meanwhile, however, I believe that the new highs in the free market price of gold stem from steady buying in the face of slumping European economies. Almost all nations are now committed to attempt to "insure" prosperity, and winding up the printing presses is now the method in vogue for bringing in prosperity. Against this, nations and individuals are seeking the time-honored way of protecting their assets. They are accumulating gold.

According to expert Fraz Pick, individuals have boosted their gold buying by 31% in the last four years, and the total gold held by individuals is now almost $30 billion, approaching the $36 billion in reserves held by all the central banks. Meanwhile, renewed demand for gold has sent it sky-rocketing to $70 in Pakistan, $60 in Japan, Taiwan and Cambodia, $80 in India. Of late, the weekly chart below shows demand steady on the upside, while reactions are weaker and weaker.

I think it is particularly dramatic to witness the free market price of gold in London a full $5 above the highest price being talked about in regard to a potential dollar devaluation. Those buying gold at $44 and up an ounce are well aware of the U.S.'s "possible intention" of a 5% to 10% raise in the dollar price of gold. They are not interested; they are looking ahead, and the price stays around the highest level in history (see chart).

Economist Eliot Janeway notes in a recent report (and I believe this is critically important) that dollar creditor nations have been massive "captive buyers" of dollars. The reason is clear. The economies of the Free World are slumping badly, and these nations are growing more and more fearful of dollar devaluation. They are buying up dollars to keep the dollar from caving in against their currencies and thus, in effect, staving off "re-valuation" of their own currencies. As Janeway puts it, "...The reality at last surfacing is that the dollar-holding powers now need devaluation of their own currencies."

The fact is that as European economies sink into recession, it is going to be harder and harder to bring off the deal America wants. It would appear to me that if some sort of temporary currency alignment including a removal of the 10% U.S. surcharge is not put in effect by early 1972, the result is going to be the beginning of international trade wars.

Add to this the collapse of phase II, the beginning of another build-up in inflationary forces, and an almost assured U.S. budget deficit which will be titanic, and we get a picture which could turn chaotic during 1972. If phase II becomes totally unworkable (and I feel that this will come to pass during 1972), Mr. Nixon will have to face the spectre of much more stringent controls and much harsher anti-inflation measures all the way down the line. With this strong possibility during an election year, the outcome is anyone's guess.

NOTES: The combined silver-gold chart shows gold still heading higher as outlined in the preceding section, but even more interesting is the potential October-November-December base in spot silver. Personally, I suspect that silver actually is basing out here, now that every commodity trader in the country has "lost his shirt" on silver contracts and has sworn off silver forever.

I include weekly charts (courtesy of Quote Digest, Box 213, Wichita, Kans. 67201) of three leading silver mining stocks. All are way off their highs of the past year, and I believe that they can be purchased now for long-term appreciation. Great patience may be needed, but silver, like gold, is greatly undervalued at this time (as are the stocks of the silver and gold producers).

The Amro-Pierson 50-Stock Average indicates that world stock markets are still far from enjoying any year-end boost, and I expect this index to sink to new lows during the first quarter of 1972.